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How Investors Are Looking at Long-Term Investments Today

Current social and economic trends exert a powerful influence on the attitude of those investing money

***By* EDWIN C. EDMONDS**

FOR years a common rule of investment has been: invest for the *short term* when money rates are *going up* and invest for the *long term* when money rates are *going down*. Naturally many other considerations affect the final decision to make or not to make a specific commitment; but I believe this fundamental principle still governs the general trend of investment thought at any given time.

Until about ten or fifteen years ago, this country had been experiencing a long period of growth during which interest rates climbed higher and higher following the low period of the late nineties. During all these years, from the early 1900s to 1929, institutional investors had found it profitable to lend for the short term because it was usually possible to reinvest to as good or better advantage when the loan matured.

It was definitely a lender's market and the lender, generally speaking, made the most of it. Short maturity, low ratio, high interest loans were the rule. Second mortgages at higher rates were very profitable; charges and commissions were always paid by the borrower, both at the time of origination and for the frequent renewals. The rapid growth of our country during that period was phenomenal. Real estate, for the most part, increased in value. This meant that one could safely invest in straight mortgages and thus obtain the highest possible net return from any investment.

TO us this is one of the clearest and most competent discussions of the factors underlying mortgage investment problems today we have read. It is regrettable that those at the Conventional Loans Clinic in New York did not have the opportunity to hear Mr. Edmonds give it personally, but lack of time was the reason. We advise them to read it now because Mr. Edmonds has set down some opinions and observations worthy of careful consideration. He is assistant treasurer of the Ohio National Life Insurance Company of Cincinnati.

Since those days many things have changed—so many that I can't begin to mention them all here or discuss how they took place. Let us then jump immediately into the present. What do we find?

First and foremost, we are in a *borrowers'* market. I have heard it said that there is no loan today that cannot be placed on the desired terms if one shops far enough. This is probably not far from the truth. Fifteen and twenty-year conventional loans are common and twenty-five year FHA loans find a ready market at a premium. Prepayment privileges are dictated by the borrower. Commissions and expenses are paid by the lender. Loan ratios are commonly 66-2/3 per cent and run up to 90 per cent. Amortization is a cardinal rule, and the second mortgage is almost a thing of the past. *Why this change and what does the present day investor have to look forward to in the long-term field?*

I believe that a fundamental change that has caused this complete reversal of the investor's idea of a desirable loan has been the change in trend of interest rates from a rising rate to a falling one. The rent charge for money has been decreasing for ten years and we see little indication of a reversal of that trend. For almost the same length of time, foresighted institutional investors have been putting funds away on a long-term basis whenever possible on the theory that tomorrow's investment would be made at a still lower rate than today's.

The further increase of our federal debt and continuance of deficit financing operations would seem assured in view of

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Would a fixed fee plan be better for compensating correspondents?

IT'S WORTH CAREFUL ANALYSIS

says **J. S. CORLEY**

THE observations I have to make here are based on the assumption that "admitting that the differential plan of compensating a correspondent is the best plan," can the system be improved? Starting from there, I am wondering if it would be better to arrange a continuing flat fee per unit basis to supplant the present system wherein the compensation diminishes with the declining balance. Thus, through some such plan, some of the inherent weaknesses of the present system (we all know what they are: lack of income when most needed, and when new loans are not available and the loan account materially reduced) might be eliminated from the correspondent set-up as we know it today.

The way I've put it here, it is unnecessary to defend the differential plan of compensating correspondents. But let us review the advantages of the differential plan over the cash commission plan. Otherwise, in an effort to improve, we might overlook some important favorable factors that should be retained.

In contrast to the commission plan, the differential plan provides an income in periods of economic distress when servicing is most important and costly; it makes possible the determination of real profits; it provides an incentive for effective collection efforts in that income is primarily dependent on actual collections; it does not make the short-term loan more attractive because of more frequent renewal commissions; and it is not dependent (except within practical limits), upon the constant addition of new business.

The rather general acceptance of the differential plan at this time is based on the belief that, in the event of another serious depression, its use will help to prevent the mortality among mortgage bankers experienced in the last depression. Here it is interesting to note in passing the trend toward branch offices on the part of the larger lenders and to speculate on the contribution to this trend made by the faults of the commission plan.

THIS article of Mr. Corley's, and its companion piece, the article by W. Walter Williams, makes up one of the most interesting and thought-provoking discussions we have encountered in a long time. If you were at the New York Convention it was contemplated that you would encounter both pieces in the form of addresses by the men who wrote them; but, because of the length of the discussion revolving around some of the earlier addresses, these two were withdrawn. Mr. Corley is assistant treasurer of the Bankers Life Company of Des Moines and Mr. Williams is president of Continental, Inc. of Seattle.

What fault, if any, can be found with the differential plan?

It is that the amount of compensation automatically decreases with a given loan or group of loans made at about the same time. And eventually this decreasing amount reaches a point where the returns are no longer profitable. This can be remedied by setting up reserves out of the income from the earlier years; but there are involvements of accounting, taxes and business policy difficulties which complicate this solution. Parenthetically, the question might be asked as to how many mortgage bankers set up reserves under the commission plan where reserves were even more imperatively needed. Reserves are desirable but not as essential under the differential plan because it is evident that the largest returns are received in the first few years when properly made loans should require the least expense for servicing.

Probably we can assume, further, that during these earlier years there will be a continuing volume of new business which will serve to hold the income from differentials at a constant, if not increasing figure. The trouble will come if, and when, our next depression lasts long enough so that differential income, reduced by pay-offs, foreclosures, and delinquent payments, is insufficient to meet the costs of promised servicing. In other words, any lessening of payments may be expected in the time of greatest need for income, which is the opposite of the most desirable relationship.

It has been suggested that a fixed fee basis would be an improvement over the differential system. On such a basis, the banker would receive a constant sum during each year of the life of the loan. The payments, obviously, would be less in the earlier years than under the differential system, but would tend toward the average of the return realized under that system. In effect, the holder of the loan is creating and holding for the banker the reserves so desirable and necessary to tide over emergency periods.

It can be suggested that a fixed fee would remove the temptation to promote rewriting of loans when the income under a differential arrangement has been materially reduced. It is also believed that accounting simplification would reduce costs for both the banker and lender. If these several advantages can be proved, it would seem that a fixed fee plan would retain the desirable advantages of the differential plan over the commission plan; and, further, that it has advantages over the differential plan.

I have been unable to discover that the fixed fee plan has been tried, or that there has been any study made of the possibilities of its application. Since there is, so far, nothing much more than a suggestion to conjure with, it would be presuming entirely too much if I were to urge the fixed fee plan as a perfect cure-all. Furthermore, it is beyond the scope of this article to attempt an all-inclusive argument in behalf of the plan. There are objections and difficulties which

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Would a fixed fee plan be better for compensating correspondents?

IT'S TOO UNPREDICTABLE

says **W. WALTER WILLIAMS**

WHATEVER system of compensation is adopted for a correspondent, it must rest upon this fundamental principle: it must be *fair* to both investor and correspondent. A fair formula for service fees between principal and correspondent, in turn, can be evolved *only* if there exists full and complete confidence between the two.

The average human mind is instinctively braced against change. Thus, the instinctive reaction to the flat fee method of compensation to correspondents is one of opposition, if for no other reason than that is new, different. Nevertheless, sometimes in the solution of a problem, experience teaches that *inaction* is the best kind of action to take. These two statements are made so that we may recognize, on the one hand, that we must try to consider the question before us without prejudice simply because it is new and untried; and on the other hand, that we must not get frantically excited to change to a new system merely to *change* to a new system.

Probably the chief advantages of the flat fee system would come down to:

1. Steady, dependable, level income to correspondents throughout the entire life of their loans, thus permitting stabilization of office procedure and operating expense.

2. Simplification of bookkeeping for both correspondent and principal.

3. Elimination of temptation on the part of correspondents to have unprofitable loans paid off by refinancing when service fees on the percentage plan became too low.

These seem like certain real advantages; and no doubt they are. But consideration of the other side of the question brings forth more distinctly potent arguments *against* the flat fee plan:

1. The flat fee plan would be difficult to employ because of the various types of loans. Some loans, mostly residence loans, are repaid on the monthly payment basis. Other loans, notably those on commercial properties, are repayable on a semi-annual interest and principal basis. It might be difficult to adopt a flat fee formula which would apply fairly and scientifically to various *types* of loans.

2. The flat fee plan would be difficult to employ in loans of various *amounts*. The problem of arriving at a fair service fee for a loan of $100,000 would be different from that of attempting to find a formula for servicing a $4,000 residence loan.

3. Servicing requirements are different even among the same *types* of loans.

THE theme of Mr. Corley's article is a new plan for compensating correspondents and one which it seems deserves serious consideration. He points out that it may have great advantages in times of economic disturbance. He says it might provide for the banker receiving a constant sum each year during the life of the loan. He does not, however, recommend it as something that could be adopted immediately. Mr. Williams agrees and contends that there are too many unknown factors in it now to make it feasible—although he acknowledges that in theory it has advantages.

Thus, a residence loan of the conventional type presents a different servicing problem than an FHA residence loan.

4. FHA loans constitute a particularly large bracket of the average correspondent's servicing portfolio these days. I suggest that the experience gained with this type of loan, either by correspondent, principal or FHA itself, is too limited to determine intelligently at this stage just what *is* a fair service fee. Thus it may well be argued that the present generally-accepted plan of payment of service fees in this type of loan (viz., a percentage of the reducing balances payable monthly out of collections) be continued, modified by a periodic review between correspondent and principal to see whether the compensation is fair and proper in the face of accumulated experience.

5. Interest rates change from time to time, and are entirely beyond the control of both principal and correspondent. In the face of the cyclical swings of the economic pendulum, affecting interest and other factors in the national economy, a long range payment plan on the flat fee basis might easily become outmoded over a period of a few years. We need only to look back a very few years to recall that FHA loans were reduced from 5 per cent to $4\frac{1}{2}$ per cent and the $\frac{1}{2}$ per cent fee from the borrower eliminated (a total of 1 per cent to be divided between principal and correspondent), to realize that these changes do come along and are very real.

6. Loans are constantly being prepaid, in full or in part. This being so, the very argument for the flat fee system, based on simplicity, might find itself upset by complications making calculations quite difficult. Furthermore, particularly in FHA loans, experience is as yet too limited to be able to hazard more than a wild guess as to what the average length of time will be before FHA loans are repaid or refinanced. Thus it becomes next to impossible to formulate a flat fee formula that may even come close to what experience will prove to be.

7. It is yet too soon to predict what the foreclosure record will be in FHA loans. Any flat fee system introduced to cover this class of loans would be unscientific at best until we have a fuller knowledge based upon some years of experience of what the foreclosure rate will be in FHA loans.

8. The principal or investor would not like a flat fee system in the latter years where pay-outs for service fees would be disproportionately high to the interest received on the small payments. Thus the principal, being human, would be tempted to do something to eliminate

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Would a Fixed Fee Plan for Correspondents Be Practical?

(Conclusion of J. S. Corley Article from Page 2)

suggest themselves, for some of which there are probably adequate solutions.

But it may be that there are some objections which would prove, upon analysis, to be of sufficient merit to make the plan less desirable than either or both of the compensation plans tried previously.

THE OBJECTIONS

As examples of the objections, may I suggest the following as typical of those which will have to be considered carefully by anyone contemplating a change to a fixed fee basis. It may be difficult to determine a fixed fee which will be a reasonable equivalent of existing differential arrangements. This determination is complicated from the banker's viewpoint because of the impossibility of forecasting with any certainty the life of a particular loan or any group of loans. We do not have experience records on which to predicate the average life of the newer types of supposedly long-time loans. Obviously, if the average life is too short, the banker will receive less under the fixed fee plan than under the differential. From the lender's viewpoint, it would appear that the fixed fee should be terminated some little time before the maturity of the loan. Otherwise, the lender would be paying out more in fees during the later years than was being received as return on the investment.

Theoretically this is possible, but it is doubtful that any lender would subscribe to such an arrangement. On the other hand, the banker would not suffer by a termination of the fee at an equitable time prior to the final maturity of a given loan since there is no reasonable expectation that there would be anything more than nominal servicing costs in the last few years. In making a comparison with the differential plan, we can assume the fixed fee termination would come at about the time when the differential return would diminish to a negligible amount with no profit value.

Another practical difficulty would arise from borrowers' requests to make substantial prepayments or for a reduction in interest rate. Either or both of these types of requests would materially affect the lender's profit margins and revise the earnings expectancy of the loans. Under the differential plan, both the banker and the lender have a mutual interest in discouraging either too rapid repayment or interest reductions. Under the fee plan, the lender is the only loser by a changed loan program not involving complete repayment.

Then, too, the lender may feel that under the fee plan, there is not sufficient incentive for the banker to be diligent in collecting interest. It would seem the risks are mutual in this connection, however, and it is doubtful if this is an important objection to the plan.

If the fee plan is to be studied, it is apparent that, from a practical standpoint, the question can immediately arise of the desirability of a loading factor in the earlier years to compensate for acquisition costs and the possibility of early repayment.

Perhaps a scale down by multiple year periods would prove the best solution. Again, it can be asked—should the fee be paid annually or should it be divided into the payment periods of the loan to which it applies? Also, should the fee be larger for loans with more frequently recurring payment periods because of the slightly greater overhead, or should the fee be smaller on the theory that the more frequent periods insure better performance and less likelihood of termination of the fee by foreclosure?

PLAN MERITS STUDY

Any study made should avoid approaching the problem by considering a *single* loan. Unquestionably, it will be necessary to know the effects of prepayments, size of units, refinancing and foreclosures on a very large number of loans before all answers are found.

I have tried to suggest some of the good points of the fixed-fee plan, and some of its problems as well. Personally, I am not convinced that the general adoption of such a plan would be desirable or make for improvement in compensation methods; but I do believe the plan has sufficient merit to warrant more exhaustive analysis that might determine if and how it could be made workable.

W. WALTER WILLIAMS' VIEWS ON FEE PLAN

(Continued from page 3)

such loans from the books just as the correspondent, being human, would be tempted to do something to eliminate such loans from the books under the present system of payment on the basis of declining payments.

9. Rather than pay a larger-than-adequate fee on the declining balance plan in the hope or expectation that the correspondent will set up adequate reserves, or to pay a lesser amount on a flat fee basis on the theory of holding back a sum in reserve for the correspondent, I think it to be a sounder, fairer practice for a principal to pay what is fair, right and proper *currently* for a *current* job to be performed, with suitable review periodically as to what that fair figure should be.

Summarizing, it would appear:

First, that a flat fee system would seem to offer a hope for an improved system of compensation to correspondent by principal, but that,

Second, too many unpredictable and variable conditions enter into consideration of the problem to make such a plan practically feasible, and that,

Third, the simplest, fairest and soundest procedure for both principal and correspondent would seem to be to review all the factors and conditions bearing upon the problem periodically, say once each five years (or oftener, if violent swings in the economic cycle one direction or the other justify) and thereby arrive at a formula that is *fair* to both parties in the light of these factors and conditions at the time of review.

High on the list of bills pending is the threat contained in the Fulmer Farm Credit Bill, now under initial consideration by the House Agriculture Committee. The American Bankers Association has analyzed the bill presented by Congressman Fulmer and finds that it is closely akin to the much disliked, and hard-fought, Jones-Wheeler bill of an earlier session of Congress. The measure would centralize farm credit, force low interest rates, grant subsidies and generally affect the whole machinery of farm credit and federal land bank procedure.

—*HOOSIER BANKER.*

What Would You Say About These Two Valuation Problems?

One of them: To what extent can land, when and if improved, be valued more than its sales price as vacant land?

By E. L. OSTENDORF

THE thoughts I have put into this article stem from an examination of two questions:

To what extent can land, if and when improved, be valued above its sale price as vacant land, particularly when comparable vacant land is available at similar sale prices and when net income will support a greater appraisal than reproduction value of the improved property?

Similarly, when the percentage clause of a lease produces a rental that permits a capitalized appraisal in excess of replacement value or value of adjacent properties, can such excess rent or income be used in making a fair appraisal?

When net income supports a value in excess of reproduction value of an improved property, generally speaking, that portion of the net income above the amount required to provide a normal return on the reproduction value, is considered as *excess income*. As such, it assuredly does add to the value of the property as of a given date. But the part of the value to which it adds may waste or spend itself more rapidly than does the value supported by the normal rental on reproduction value. Furthermore, the translation of that excess income into value calls for quite a different treatment than that which we apply to a normal or stabilized income.

To begin with, the income which supports this value in excess of reproduction needs some scrutiny:

Why is it so?

Why is the tenant agreeable to paying more than a normal rental?

For how long a period has the tenant agreed to pay this rental?

How responsible is the tenant and can we be reasonably certain that the specified rent will be paid for the term of the lease?

Is the lease legally unbreakable?

In order to narrow the problem, let us assume that the tenant is outstandingly responsible and fulfills his obligations.

THE real title of this article is in paragraphs 2 and 3 of the text—not what we have labeled it. (But try and put into a few words these two thoughts—we did, with no success.) Many members have written to say that they thought this address was one of the outstanding contributions to the Conventional Loans Clinic in New York. Mr. Ostendorf is vice president of Ostendorf-Morris Company of Cleveland and a former president of the National Association of Real Estate Boards.

I would still want to check another phase of the case: *Is there anything of a special purpose nature about the improvement? Would the average tenant be able to use it, as is, or will it require some considerable conversion at the end of the present tenant's lease?*

If the building partakes to a considerable or complete degree of the nature of a special purpose improvement, the excess probably should be attributed more than normally to a write-off of the improvement. Probably the special purpose improvements should be completely written off during the term of the tenant's lease. If this latter assumption be the case, then, perhaps, the rental is a normal one—that is, the average prudent investor would not invest his money for a lesser return. All these points require investigation.

Then again another element requires consideration—*What is the nature of the tenant's business? Is it what may be termed as a "magnet business"?*

That is to say, does it attract a large number of people, with buying power, to itself and therefore to the immediate proximity of the property under appraisement? If it is in that category, then that other "comparable vacant land" will tend to increase, not only in value but in price asked by its owner. In this latter situation I would certainly attribute all or part of the excess rental to land.

So there are many points to be determined before coming to a definite answer to this problem. In order to reduce the problem to a particular sort of a case, let us make the following assumptions:

1. The improvement is in no sense a special purpose building in that it has approximately equal utility worth to a number of possible tenants.
2. The building is a new one.
3. The tenant is completely reliable financially and the lease is air tight and cannot be broken.
4. The economic life of the improvement exceeds the term of the lease.

Now let us assume that a rental of $15,000 per annum will allow 5 per cent on the comparison value of the land and retire the cost of the reproduction of the improvement over a fifty year life with an interest return of 6 per cent. Now we find that instead of $15,000 there is $16,500 rental received under the lease. What do we do with this excess of $1,500?

It isn't quite as stable or seasoned or secure as the normal rental. And it only lasts for the term of the lease at best, so far as we can now tell. Accordingly, we take a factor which will give us the present worth of $1,500 per annum for the leased term on a 7 per cent basis. I am inclined to take a somewhat higher rate of capitalization on the excess rental than on the normal for the reason that this excess rent does suggest the possibility of some degree of risk even though

our tenant is good. Tenant responsibility plus land plus bricks and mortar should be a safer investment than tenant responsibility alone.

Then we get a result. The question now is: *What do we do with this piece of value found?*

If the neighborhood was a growing one with prospects of increasing supporting buying power, I might add it to land value or I might add it to the whole under the label of Mr. Entrepreneur. I might divide it between land on the one hand and entrepreneur increment on the other. From a practical standpoint of total value I doubt that it makes a great deal of difference *where* you allot it. From a practical standpoint of security for a mortgage loan, it makes *a great deal of difference* where the increment is alloted. If the excess income is substantial, and the lease has but 5 or 10 years to run, then the provisions for rapid loan amortization during the period of the lease are very important. If the loan is not amortized, with sufficient rapidity, then the ratio of the loan to the value of the property as a whole might increase rather than remain stationary or decrease.

EXCESS RENTAL

In Ohio, the laws governing the lending practice of insurance companies state that the value of the property must be based on the value of the land plus the value of the building. Since an entrepreneur increment can be classified neither as land nor building, some insurance companies have failed to recognize that the increment is just as much a part of the value of the whole as is the land, the brick, the steel, the plumbing, and other components.

But there is another facet to the problem as it has been propounded: *What happens in the case of an excess rental being produced as a result of a percentage clause in the lease?*

In a sense, that is a somewhat different problem. In these days of anticipated inflation, percentage leases do offer an attractiveness to investors because they are a hedge against inflation. On the other hand, the excess yield coming from the percentage clause carries the guarantee of no responsible concern. It is a variable amount. Certainly I would not accept it for the future in

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In Memoriam
Sylvanus B. Nye
1874-1941

MBA members were shocked and saddened to learn of the sudden and unexpected death on October 18th of its Past President, Sylvanus B. Nye of Buffalo, New York. As one of MBA's "elder statesmen", Mr. Nye had served the Association in many responsible positions. No member contributed more to the progress of the Association over such a long period of years than he did; and in his passing MBA has lost one of its most valuable and highly esteemed members.

Mr. Nye was born in Cayutaville, Schuyler County, New York. He was a descendant of pioneer New England settlers who came to the United States in 1666. He obtained his early education in the Ithaca schools and went to Cornell University where he studied law, graduating in 1898.

He was admitted to the New York Bar that same year and moved to Buffalo where he began the practice of law. He specialized in real estate law and in the management of estates and investments. This gave rise to his own interest in this field. In 1902, he was married to Miss Henrietta M. Patterson and they had five children who survive.

Mr. Nye was a 32nd degree Mason and a member of the New York Real Estate Association, the Buffalo Chamber of Commerce and the State and Erie County Bar Associations.

In Buffalo, Mr. Nye was particularly well-known as the developer of Nye Park, one of the City's best known residential districts. This is a famous plot of ground because it was the site of the Pan American Exposition.

He was a director of Abstract Title & Mortgage Corporation, National and Buffalo Real Estate boards, Building Managers' Association, Main Street Association, Buffalo Historical Society, Society of Natural Sciences, Society of Natural History, Sons of American Revolution, Buffalo Association of Fire Underwriters, New York State Association of Local Fire Insurance Agents, and the National Association of Insurance Agents.

SYLVANUS B. NYE

Mr. Nye was a vice president of the Hotel Roosevelt, New York City; an organizer and director of the Paramount Fire Insurance Company, and vice president of the Nye Agency, Inc.

He headed MBA during one of its most difficult years, that of 1932-33. His contribution to MBA was an important and a much appreciated one; he will be missed.

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NOVEMBER 1, 1941

RE: SPAB

Not in years has a development affecting mortgage banking created so much confusion and genuine bewilderment as the SPAB order of nearly a month ago. The two tests to apply to any building project were clear enough—at first glance. But it was in the widespread ramifications, the questions raised but not readily answerable, where the trouble began. And trouble there has been—plenty of it. So much so that Donald Nelson has written Senator Wiley of Wisconsin that:

"I believe the nature of this policy has been somewhat misunderstood."

As existing shortages in critical metals become more acute, Mr. Nelson said, it becomes more and more difficult for a builder to obtain structural steel, plumbing and heating equipment, without a priority rating.

"Within a few months it may be practically impossible for the builder to obtain such items without priority assistance. Consequently the policy means that henceforward IF a builder is unable to get these metal items without a priority rating he will not be able to get them at all unless he can satisfy the division of priorities that the job he is working on is essential to the nation, either directly for national defense or indirectly as a safeguard to civilian health and safety."

Thus he explained, while the policy puts sharp limits in new construction, it is far from being a blanket "stop building" order. Such basic materials as brick, stone, mortar, concrete and clay products are not particularly short and may be obtained freely for any building whatever.

"The man who plans a construction job which used only those materials . . . is as free to go ahead now as he was a year ago.

"I think it is important for every one to understand the following points as well. Although we have undertaken to grant help, where possible, in order that needed buildings now under construction and substantially along the road to completition may be finished, that policy will not apply to building begun hereafter."

The opinions as to the ultimate effects of SPAB's order are still as diverse as they were nearly a month ago. *Time's* view closely approximates the opinion we held after issuance of the order:

"Actually the announcement, when analyzed, meant little more than what SPAB said two weeks before in ordering priorities for defense housing."

Thomas S. Holden in his recent Defense Supplement No. 3 offered a conclusion which, to us, seemed rather apparent when the order was first issued. He said:

"It is generally understood, though not officially stated, that this surprise order was brought about largely by the great accumulation of pressures upon the Priorities Section of OPM to grant critical materials priorities for great numbers of public and private construction projects having no genuine claim for preferential treatment on the basis of necessity."

Holden's opinion was strengthened when Nelson spoke a few days ago before the American Municipal Association and warned his listeners to make that old fire house or other municipal building do for the present because the materials for new ones weren't going to be available for projects of that sort for some time to come.

It begins to appear that, while it is acknowledged that new building is in for some curtailment during the emergency, it does not (as Nelson said) mean a stoppage by any means—nor does it appear that *The American Banker's* opinion, typical of many others, represents what is ahead:

"The order issued by SPAB, virtually curtailing all construction projects not immediately and intimately tied to defense needs, will vitally curtail all FHA loans, it is indicated in Washington."

But we must admit, we're not as optimistic as the head of the Flintkote Company when he said in his annual report that:

"Priorities prohibit nothing . . . they help! SPAB simply has said it will not grant priorities for any type of construction not essential to defense and public health and safety. This does not prohibit other types of construction.

"Any builder, anywhere, can build any number of any type of buildings he wants to build provided he can get the materials. SPAB will not stop him, but it will not help him with priorities. Local inventories and the willingness of lending agencies to continue to finance non-defense construction are the determining factors in speeding or hindering construction."

The head of Flintkote also made a prediction that, from what we have read and heard the last week, may be a whole lot closer to the actual future than most mortgage men believe now. He said:

"A realistic assumption appears to be that while there will be less building in 1942 than in 1941, next year still will be a good building year measured by any but the boom standards enjoyed in the current year."

Of course there's always the possibility that next month, next week—tomorrow—something new may be decreed, and that it will mean starting all over again in your thinking and your planning. Because, as the *Wall Street Journal* points out, SPAB has the power, it can act.

"SPAB is the youngest, toughest, smartest and—so far—most successful defense agency. The secret of its success, as one member remarked, is its willingness to tackle and settle a problem just as though it had been taken to the President. It talks turkey to all of them. If a coalition of Wallace, Hopkins, Henderson, Nelson, Stimson, Knox, Knudsen and Hillman isn't the next thing to Roosevelt, nothing in Washington is."

The 1941 Year Book is "in the works." In the meantime, do you want another copy of the 1940 Year Book—at $1.

E. L. OSTENDORF ARTICLE

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calculating my appraised value, unless it had been pretty thoroughly established by more than a year or two years record.

There is still another element to consider. Sometimes a base rental is established knowingly below the fair market rental, in order for the lessor to obtain a responsible and continuous tenantry. In this case, the base rental plus the excess rental may no more than equal the fair market rental, and actually there is no excess to capitalize.

If I had adequate ground for concluding that a given store would continue to produce an additional rental paid by way of percentage, I would stabilize the percentage rental and apply a high risk rate.

The appraiser is more and more called upon to understand merchandising practices, neighborhood potentialities, evaluate the plus sales created by superior management, and recognize the trend of costs in doing business, all of which result in a store rental. When all these facts about the given rental are known, the application of different risk rates to varying parts of the rental can be fixed with human certainty and supported with the utmost conviction.

Edwin C. Edmonds on Current View of Long-Term Investing

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the imminence of a full war economy. This means that the carrying charges on our federal debt will become larger and larger in terms of dollars and cents. It is only logical to expect those in charge of our fiscal policies to exert every influence to keep interest rates low.

INFLATION NOTED

Also that peculiar result of deficit financing which acts to increase bank deposits has created a basis for expansion of lending capacity to such an extent that there seems no reason to believe that increasing business activity could possibly decrease that base through borrowings to such a degree that the rate would be affected. It is true that we hear a good deal today of the possibility of inflation taking hold, and some evidences of inflationary tendencies have indeed become evident. Normally this would be considered a forerunner to a firming of interest rates. Likewise the measures proposed in some quarters of the government as anti-inflationary moves would normally indicate a possible turning point.

Nevertheless, the immediate effect of the recent announcement by the Federal Reserve Board raising reserve requirements was to send the government market still *higher*, the yield still *lower*. Apparently, investors still consider the present return entirely adequate and see no reason to delay investment on the hope of a rising trend.

But there are other things the institutional investor in long-term mortgages must think about. One of these is the supply of long-term paper. Undoubtedly a secondary factor in the ready acceptance by the investor of the liberalized mortgage practices has been the shortage of demand for long-term loans. The complete stagnation of the building industry during the early thirties resulted in a dearth of mortgages which, when coupled with an increasing demand as a result of decreasing interest rates, led to a competition for the available supply. This competition grew steadily greater as bank deposits increased, particularly as industrial financing of all types dried up. The result, of course, is self-evident; and, at the moment, it would appear that this shortage is not going to be decreased in the foreseeable future. Rather the recent announcements concerning priorities for construction would indicate a further decrease in the future supply of mortgages.

From the standpoint of return and availability of supply, it would so far indicate that the long-term investor had better get busy and get what he can without delay. However, there are still other considerations to be looked into. What of the security itself? Without question, most competent evaluators today give every possible consideration to the item of depreciation, both past and future. This is as it should be, especially since this country of ours has apparently passed beyond that period when real estate continually advances in value. The recognition of this is present in the common usage of amortization as an offset to depreciation loss.

But it occurs to me that we may not have been giving enough emphasis to the item of obsolescence. The term is common enough; everyone will acknowledge that obsolescence does take place. Is it possible that when this war is over, and the full force of the new findings in methods, processes, and substitutions necessitated by war, are turned to peaceful pursuits, a tremendous number of our valuable features today will be rendered obsolete almost over night? If this is possible, it may be wise for the long-term investor to look twice to the security and its evaluation before determining the amount of a long-term commitment to be made upon it.

RE: FARM LOANS

Traveling into another field of investment, that of farm mortgages, we find in recent years a revived interest on the part of institutional investors, particularly insurance companies. In 1917 the Federal Land Bank System began experiments with a liberalized plan of mortgage lending. During the long hard farm years of the late twenties and the thirties, most other investors abandoned this particular field and left it to the Federal Land Banks almost exclusively. Since the depths of 1932, this farm problem has continually had the attention of the federal government. It would appear that the farmer is going to continue to receive the benevolent attention of his government in the future. It is fairly well recognized now that for the nation as a whole to prosper, all parts of that whole must obtain some of the benefits of a prosperity. This will include the farmer. Apparently the farmer's lot in the future, while it may not be extremely rosy, at least appears to be stabilizing. His promise to pay over a long period of years would seem to be good security for the investor.

There are today a thousand and one uncertainties concerning the future possibilities of any investment. Men of long experience in the field of institutional investment tell me that never in their experience has it been so difficult to chart a safe course as it is today. This I can readily believe. One thing, however, does seem definite to me: *a sound long-term mortgage is, at this particular time, still a highly desirable investment medium.*

Urban home financing exceeded three billion dollars during the first eight months of 1941. *During August,* 144,700 *mortgages were recorded amounting to* $428,000,000 *by all types of lenders. Banks and trust companies recorded* $105,000,000. *Individual mortgage lenders recorded* $69,000,000.

The assessed value of property in the United States declined from $168,000,000,000 *in* 1929 *to* $139,000,000,000 *in* 1938, *or* 17 *per cent.*

The total values declined in the face of a 6.6 *per cent increase in the population during the period. Computed on a per capita basis, the decline measured* 22 *per cent over the* 10-*year period — from* $1,376 *per person in* 1929 *to* $1,073 *in* 1938.

HOLC recently surveyed its eight-year reconditioning experiences and how its "reconditioning dollar" was spent. Painters got the largest share of the $166,000,000 *which was spent for repairs on* 550,000 *homes, under the direction of the HOLC, from* 1933 *to April* 1, 1941. *Of the* $52,000,000 *spent for both exterior and interior paint jobs, labor got over* $33,800,000 *and about* $18,200,000 *went for materials.*

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